# Contributing to your employer's 401(k) plan: How it works

If you're fortunate to have an employer that offers a 401(k) plan, and you don't contribute to it, you may wonder if you should participate. In general, it's a great tax and retirement saving deal! These plans help an employee accumulate a retirement nest egg on a tax-advantaged basis. If you're thinking about contributing to a plan at work, here are some of the advantages.

With a 401(k) plan, you can opt to set aside a certain amount of your wages in a qualified retirement plan. By electing to set cash aside in a 401(k) plan, you'll reduce your gross income and defer tax on the amount until the cash (adjusted by earnings) is distributed to you in the future. It will either be distributed from the plan or from an IRA or other plan that you roll your proceeds into after leaving your job.

**Tax benefits**

Your wages or other compensation will be reduced by the pre-tax contributions that you make, which will save you current income taxes. But the amounts will still be subject to Social Security and Medicare taxes. If your employer's plan allows, you may instead make all, or some, contributions on an *after-tax* basis. These are Roth 401(k) contributions. With Roth 401(k) contributions, the amounts will be subject to current income taxation, but if you leave these funds in the plan for a required time, distributions (including earnings) will be tax-free.

Your elective contributions — either pre-tax or after-tax — are subject to annual IRS limits. In 2023, the maximum amount permitted is $22,500. When you reach age 50, if your employer's plan allows, you can make additional "catch-up" contributions. In 2023, that additional amount is up to $7,500. So if you're 50 or older, the total that you can contribute to all 401(k) plans in 2023 is $30,000. Total employer contributions, including your elective deferrals (but not catch-up contributions), can't exceed 100% of compensation or, for 2023, $66,000, whichever is less.

In a typical plan, you're permitted to invest the amount of your contributions (and any employer matching or other contributions) among available investment options that your employer has selected. Periodically review your plan investment performance to determine that each investment remains appropriate for your retirement planning goals and your risk specifications.

**Taking withdrawals**

Another important characteristic of these plans is the limitation on withdrawals while you're working. Amounts in the plan attributable to elective contributions aren't available to you before one of the following events:

- Retirement (or other separation from service),
- Reaching age 59½,
- Disability,
- Plan termination, or
- Hardship.

Eligibility rules for a hardship withdrawal are strict. A hardship distribution must be necessary to help deal with an immediate and heavy financial need.

As an alternative to taking a hardship or other plan withdrawal while employed, your employer's plan may allow you to receive a loan, which you pay back to your account with interest.

**Matching contributions**

Employers may opt to match 401(k) contributions up to a certain amount. Although matching is not required, surveys show that most employers offer some type of match. If your employer matches contributions, you should make sure to contribute enough to receive the full amount. Otherwise, you'll lose out on free money!

These are just the basics of 401(k) plans for employees. For more information, contact your employer. Of course, we can answer any tax questions you may have.